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No. 932

IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

LEONARD S. GOODMAN and BARBARA L. GOODMAN,
Petitioners,

v.

CHARLES J. FUTROVSKY, Plaintiff-Appellee Below, and N. M. COHEN, EMANUEL COHEN, JACOB LEHRMAN, ISRAEL COHEN, GIANT FOOD, INC., CHARLOTTE FERSON LEHRMAN, JOSEPH B. DANZANSKY; and ISRAEL COHEN, EMANUEL COHEN, and LILLIAN C. SOLOMON, doing business as MAX SHAPIRO, Defendants-Appellees Below, *Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF DELAWARE

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INDEX

	Page
Opinion below	1
Jurisdiction	2
Question presented	2
Statute involved	2
Statement of the case	3
Reasons for granting the writ	7
Conclusion	14

APPENDIX:

Pertinent extracts from Respondents' argument in the lower courts	1a
Opinion of the Delaware Chancery Court	3a
Opinion of the Delaware Supreme Court	4a
Final decree or mandate	12a

CITATIONS

CASES:

Blackwell v. Bentsen, 203 F.2d 690	11
Boone v. Baugh, 308 F.2d 711	11
Cahall v. Lofland, 12 Del.Ch. 299, 114 Atl. 224, aff'd, 13 Del.Ch. 384, 118 Atl. 1	5
Cohen v. Beneficial Industrial Loan Corp., 337 U.S. 541	13
Elster v. American Air Lines, 34 Del.Ch. 94, 100 A.2d 219	5
Frost & Co. v. Mines Corp., 312 U.S. 38	2, 8, 13, 14
Gottlieb v. McKee, 34 Del.Ch. 537, 107 A.2d 240	5
Great Northern Ry. v. Washington, 300 U.S. 154	13
Hooven & Allison Co. v. Evatt, 324 U.S. 652	13
Kansas City So. Ry. v. Albers Comm. Co., 223 U.S. 573	13
Kemper v. Lohnes, 173 F.2d 44	11

Page

MacClain v. Bules, 275 F.2d 431 11
Standard Oil Co. v. Johnson, 316 U.S. 481 2
Sterling v. Constantin, 287 U.S. 378 13
Triplex Shoe Co. v. Rice & Hutchins, 16 Del.Ch. 298, 147 Atl. 317, aff'd, 17 Del.Ch. 356, 152 Atl. 342 5
United Gas Co. v. Texas, 303 U.S. 123 13

STATUTES:

Securities Act of 1933, 48 Stat. 74, 15 U.S.C. 77a:

Section 5(b)(2), 48 Stat. 77, 15 U.S.C. 77e (b)(2) 2, 7, 8, 12

Section 12, 48 Stat. 84, 15 U.S.C. 77*l* 11

Section 16, 48 Stat. 84, 15 U.S.C. 77p 3, 7

28 U.S.C. 1257, 2101(c) 2

MISCELLANEOUS:

Byse and Bradley, "Proposals to Amend the Registration and Prospectus Requirements of the Securities Act of 1933," 96 Pa.L.Rev. 609 .....9, 10, 11

Loss, Securities Regulation (2d ed. 1961) 9, 10, 11, 12

Report of the SEC on Proposals for Amendments (1941) 12

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CHARLES J. FUTROVSKY, ET AL., *Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF DELAWARE

Petitioners, Leonard S. Goodman and Barbara L. Goodman, pray that a writ of certiorari issue to review the final decree of the Supreme Court of the State of Delaware entered on October 25, 1965.

OPINION BELOW

The Chancery Court of the State of Delaware entered its unreported letter-opinion in this case (App. (Appendix hereto) 3a) on January 28, 1965, and its final order on February 3, 1965. The Supreme Court of the State of Delaware entered its opinion (App. 4a-

11a) on September 17, 1965, and its final decree (App. 12a) upon denying the petition for reargument; this opinion is reported at 213 A. 2d 899.

JURISDICTION

The court below entered its final decree or mandate on October 25, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1257, 2101(c). *Frost & Co.* v. *Mines Corp.*, 312 U.S. 38, 40; and see *Standard Oil Co.* v. *Johnson*, 316 U.S. 481, 483.

QUESTION PRESENTED

The public stockholders of a supermarket chain (a Delaware corporation) complained that the officers and directors were requiring it to purchase all its produce requirements through a middleman composed of, and thereby profiting, such officers and directors. The arrangement with the middleman was described in the prospectus connected with the first public offering and with subsequent new offerings of the corporation's common stock. The question presented is whether the Delaware court lawfully barred relief, on grounds that all public investors had consented with actual knowledge of the arrangement, solely on the holding that the Securities Act of 1933 required the prospectus be delivered to each and every prospective purchaser of the new shares prior to his effecting a purchase.

STATUTE INVOLVED

The statute primarily involved is Section 5(b)(2) of the Securities Act of 1933, 48 Stat. 77, 15 U.S.C. 77e(b)(2), which provides:

> It shall be unlawful for any person directly or indirectly . . . to carry or cause to be carried

through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 77j of this title.

Also material to this appeal is Section 16 of the Securities Act of 1933, 48 Stat. 84, 15 U.S.C. 77p, which saves to every litigant "any and all other rights and remedies that may exist at law or in equity."

STATEMENT

Petitioners are two stockholders, husband and wife, who purchased 425 shares of common stock of Giant Food, Inc., a Delaware corporation operating a chain of supermarkets in and around Washington, D. C., on the American Stock Exchange in May, 1964. Respondent Futrovsky, also a stockholder of Giant, brought the original suit out of which this appeal arises derivatively on behalf of Giant in the Delaware Chancery Court against respondents Cohen and other officers and directors of Giant. Futrovsky alleged that these officers and directors had wasted and were continuing to waste Giant's assets by requiring Giant to purchase all its produce requirements through a partnership (called "Max Shapiro" or herein "Shapiro") composed of these same officers and directors, rather than directly from suppliers, for the sole purpose of enriching these officers and directors at the expense of the corporation and its common stockholders.

Before the petitioners entered the case in the Chancery Court, Futrovsky, purporting to represent all the common stockholders, had developed a record showing that Giant issued its first public shares of common stock in 1959, but that all voting shares remained

in the hands of the officers and directors composed entirely of representatives of the two original families (Cohens and Lehrmans) which founded the chain. Futrovsky conceded on this record that he had received a prospectus in 1959, which described the arrangement between Giant and Shapiro and related that the officers and directors would continue to profit from the arrangement. But, he further developed facts beyond those set forth in the prospectus, namely that Shapiro has provided no bona fide business service to Giant since the end of World War II;[1] Shapiro owns no assets, except a small amount of working capital to buy produce for the few days before Giant pays for it (Tr. 29, 70-71); Shapiro uses Giant's trucks and accounting equipment and operates out of Giant's produce warehouse (Tr. 21, 22, 74); Shapiro's only customer is Giant (Tr. 28); Shapiro's salaried personnel, who ensure the quality of produce bought for Giant, are employees of Giant (Tr. 22, 35); and each year the Shapiro partnership receives from Giant from $350,000 to $400,000 over the cost of its operation which redounds to the benefit of Giant's officers and directors.

The plaintiff Futrovsky and the defending officers and directors, nevertheless, proposed a settlement before the Chancery Court which provided that, (1) the Giant-Shapiro arrangement should continue for another 10 years; (2) Shapiro's profit each year in this

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[1] The officers and directors defended the Shapiro arrangement only on the allegation it encouraged the Giant store managers to return defective produce, which returns had for years admittedly been *de minimis*, amounting only to one or two percent. (Tr. 26, 34-36). ("Tr." herein refers to the transcript of the depositions taken in 1964 in the Chancery Court.)

period should be $350,000; (3) at the end of the 10-year period, Giant would have the option of buying out the partnership for $1,500,000; and (4) Futrovsky's counsel should receive a fee of $100,000. (App. 5a-6a). All stockholders were notified of this proposed settlement. Petitioners and another stockholder appeared before the Chancery Court to object. When that court approved the settlement, the petitioners appealed to the Delaware Supreme Court.

Respondents argued in the Chancery Court in support of their settlement that all the public shareholders in 1959 had consented to the Giant-Shapiro arrangement, and that petitioners were now barred from attacking the arrangement by the prior consent. Recognizing that Delaware law requires actual knowledge by stockholders of any matter consented to,[2] respondents sought to establish such knowledge solely upon the assertion that the Securities Act required that each investor receive a prospectus containing full disclosure of the arrangement prior to his effecting any purchase. Futrovsky's counsel, for example, asserted in the Chancery Court that "nobody was permitted to buy a share of stock on this original issue without his first being delivered in hand . . . the prospectus" (App. 1a); and counsel for the individual defendant-respondents agreed, that each public investor was "buying his shares with this prospectus before him." (App. 2a).

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[2] *Cahall* v. *Lofland*, 12 Del. Ch. 299, 114 Atl. 224 (1921), *aff'd*, 13 Del. Ch. 384, 118 Atl. 1 (D. Sup. Ct. 1922); *Triplex Shoe Co.* v. *Rice & Hutchins*, 16 Del. Ch. 298, 147 Atl. 317 (1929), *aff'd*, 17 Del. Ch. 356, 152 Atl. 342 (D. Sup. Ct. 1930); *Gottlieb* v. *McKee*, 34 Del. Ch. 537, 107 A. 2d 240 (D. Ch. 1954); *Elster* v. *American Air Lines*, 34 Del. Ch. 94, 100 A. 2d 219, 221 (D. Ch. 1953).

The Chancery Court approved the settlement upon the ruling of law, as urged by respondents, that if the suit should go to trial, petitioners and all other public stockholders could not withstand the defenses of ratification or acquiescence (App. 3a). The court took no evidence on respondents' assertions regarding the Securities Act, for none was proffered.

Petitioners appealed to the Delaware Supreme Court, arguing that federal law did not require the delivery of a prospectus to all the prospective purchasers of new shares, and certainly not before they had effected their purchases; and that the Chancery Court had erred as a matter of law in failing to require proof that all shareholders had in fact bought their shares with knowledge of the Giant-Shapiro arrangement in 1959, and in 1961 and 1963 as further new shares were distributed, in the absence of a statutory requirement that a prospectus be delivered in time to afford such knowledge. Respondents' counsel reiterated their assertion, that in 1959 the investing "public purchased Giant's shares on the basis of the Prospectus" (App. 2a).

The Delaware Supreme Court affirmed the settlement and held further relief was "precluded." It first stated that the Cohen and Lehrman families had decided not to include their Shapiro holdings in the 1959 offering of Giant stock, and next stated that, "The buying public may not complain of that decision as long as it was not misled to its injury." (App. 9a).

The court concluded that all public shareholders had not been misled to their injury, but rather "knew" of the arrangement "at the time they were buying into Giant" (App. 9a), on the sole ground that, "Section

5(b)(2) of the Securities Act of 1933 (15 U.S.C. §§ 77, et seq.) required as a practical matter that the 1959 purchasers of Giant stock be furnished with a copy of the Prospectus" (App. 10a). The court states that "full disclosure . . . was made in the Prospectus under which the stock was offered to the public," and "in the light of this knowledge," which the purchasers allegedly had at the time they were buying into Giant, they may not now complain (App. 9a).

In further response to petitioners' argument that there was "no proof that the public stockholders of Giant in fact received copies of the Prospectus prior to the purchase of their stock" (App. 9a), the court added: "On the record before us we think we would be wrong to ascribe to the underwriters an intention to circumvent the clear intention of the Securities Act which is to force full disclosure of pertinent information. . . . We think it most probable that the 1959 purchasers of the Giant stock made their purchases with full knowledge of the separate existence of Shapiro and the intention to continue that separate existence." (App. 10a).

REASONS FOR GRANTING THE WRIT

The court below denied petitioners' relief upon the bare holding of law that the federal securities act requires the delivery of a prospectus to all purchasers of newly-issued shares prior to their effecting a purchase. As a decision of law, the court clearly erred, for the statute on its face requires no such result. Even as a piece of judicial legislation, the decision implements no federal policy, but in fact hinders the essential policy of the Act and only succeeds in destroying a State right of action which Section 16 of the Securities

Act seeks to preserve. As the court below decides much of the nation's corporate law, the public will broadly suffer under this ruling.

The ruling below applies the Securities Act against the investing public in a way never intended by Congress. The Securities Act was enacted to protect innocent investors, *Frost & Co.* v. *Mines Corp.*, 312 U.S. 38, 40, 43, but the court below uses the Act to bar the investors from rectifying an arrangement between the corporation and a middleman that profits only the officers and directors of the corporation. The prospectus is made available to management under the decision below as a shield against the complaint of the public investors.

Moreover, a prospectus serves its purpose to inform the investing public in proportion to its distribution prior to consummated stock sales. See *Frost* case, *supra*, 312 U.S. at 40. By conclusively presuming there has been distribution to all prospective buyers as a matter of law, the lower court encourages the smallest permissible distribution of the prospectus. For those with something to hide from the public in the prospectus, the decision below provides the consolation they will not have to prove that distribution of the prospectus occurred. The result would not be so inimical to the interests of the investing public but for the fact there is a wide leeway allowed by the Securities Act to avoid a wide distribution, let alone 100% distribution, of the prospectus prior to consummated stock purchases by the public.

By its own terms, Section 5(b)(2) as a minimum requires only that a prospectus "accompany" the new shares, that is, be sent to the purchaser with delivery

of his shares after the sale has taken place. Except where there is fraud, when a right of recission may apply, the completed sale very often will occur prior to delivery of the prospectus. This is uniformly recognized by the authorities in the field. *E.g.,* 1 Loss, *Securities Regulation,* 182, 246 (2d ed. 1961).

Securities may be sold orally, either in personal conversation or by telephone prior to the delivery of any prospectus, which will normally occur pursuant to Section 5(b)(2) only after the purchase has been consummated. For example, the article by Byse and Bradley, "Proposals to Amend the Registration and Prospectus Requirements of the Securities Act of 1933," 96 *Pa.L.Rev.* 609, 619, states:

> [I]f the offer or attempt to dispose of the security is made orally, either in personal conversation or by telephone, the only requirement imposed by the Act is that if the mails or channels of commerce are used to deliver the security to the purchaser, a Section 10 prospectus must accompany or precede the security. Consequently, where the seller does not utilize written communications in selling the security, *the buyer need receive no prospectus until the security is delivered to him after he has purchased the security.* [Emphasis added].

And as Professor Loss states in reference to selling securities orally, either in person or by telephone:

> Thus it is possible in many cases to offer and sell without even a technical violation, either before or after effective registration, and deliver a statutory prospectus for the first time with the confirmation or the security—if, indeed, the mails or interstate facilities are used at that stage.

To be sure the court below deftly couched its holding in language which sounds like findings of fact. It stated that the Securities Act requires delivery of a prospectus within the appointed time "as a practical matter"; and "we think it most probable that the 1959 purchasers of the Giant stock made their purchases with full knowledge . . . ". (App. 10a). No evidence or authority support these purported findings. The assertions of the court below are contrary to all the authorities which were before it. Petitioners cited the Byse and Bradley article, *supra,* for example, which states (at 617):

> To the extent that new issues are sold through oral negotiations, the Act's professed objective of providing public investors with sufficient information to reach informed judgments is not effectuated. Although detailed data concerning the percentage of newly issued securities sold orally is not available, the following statement of the securities industry is revealing: *"With respect to the greatest percentage of new issue securities measured by dollar amount . . . business between buyer and seller is normally conducted by telephone." This opinion by qualified observers indicates that despite the existence of the Securities Act, a large number—perhaps, in the language of the industry statement, "the greatest percentage" —of public investors purchase newly issued securities without full benefit of the disclosure provisions of the Act.* [Emphasis added].

See also Loss, *supra,* at 207-208. Moreover, this customary practice does not arise out of any intent on the part of underwriters to circumvent the Securities Act, but from an honestly-held industry belief that such conduct and practice were not intended to be regu-

lated by Congress. This is demonstrated in Loss, *supra,* at 209; and Byse and Bradley state (at 617-18):

> The securities industry, pointing to the deletion of provisions in earlier drafts of the Act which would have regulated oral offerings, argues that Congress deliberately chose not to impose such "an unnecessary and perhaps impossible restriction . . . upon business." We do not think it necessary to attempt a resolution of this controversy. The point is that under the Act a multitude of public investors still are not provided with information concerning the securities they are asked to purchase.

Where Congress has intended to reach oral communications under the Securities Act, it has done so expressly. Section 12, 48 Stat. 84, 15 U.S.C. 77*l*, for example, creates a civil cause of action against one who sells fraudulently "by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication." The phrase "oral communication" here "certainly would include telephone conversations as means of communication in interstate commerce and perhaps broadcasts by radio, and these two means of 'oral communication' alone might well include a large segment of the communications in interstate commerce which Congress intended to reach." *Kemper* v. *Lohnes,* 173 F. 2d 44, 46 (7th Cir. 1949).[3]

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[3] Many cases have arisen under the Securities Act involving face-to-face sales where the Act was held not to apply. *E.g. Boone* v. *Baugh,* 308 F. 2d 711 (8th Cir. 1962). Where the mails have been used only to deliver the security, the circuits are split over whether Section 12 applies. Compare *Kemper* with *MacClain* v. *Bules,* 275 F. 2d 431, 433-34 (8th Cir. 1960), and *Blackwell* v. *Bentsen,* 203 F. 2d 690, 693 (5th Cir. 1953).

No comparable language and hence no comparable intention appear in Section 5(b)(2).

As early as 1941, the Securities and Exchange Commission reported to Congress that Section 5(b)(2) does not require the delivery of a prospectus prior to effective sales of securities, as follows:

> Where the seller avoids making a written offer, a prospectus is not required to be given to the buyer until the security is delivered. *Representatives of the securities industry have stated to the Commission that it is their practice in many cases to take full advantage of the present statutory language* by entering into oral contracts with investors for the sale of securities and sending the required prospectus later, usually at the time of confirmation of the sale. *Thus the investor frequently does not see the prospectus until after he has actually become a purchaser.*[4] [Emphasis added].

Thus, contrary to the decision below it is most probable that the original purchasers of Giant stock did not receive any prospectus until the delivery of their shares occurred after they had purchased them. As Professor Loss states (*supra* at 208):

> A prospectus which comes with the security does not tell the investor whether or not he should buy; it tells him whether he has acquired a security or a lawsuit.

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[4] Report of the Securities and Exchange Commission on Proposals for Amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934, August 7, 1941, Print of the House Committee on Interstate and Foreign Commerce, 77th Cong., 1st Sess., page 5. The Commission then did not advocate a change, apparently preferring to hold the line against other changes proposed by the securities industry which would have weakened the statute even more (*id., passim*).

And, too, the absence of any evidence of record or authority below, which might be cited to support their holding,[5] shows that in substance and effect it is no more than a holding of law; and, of course, this Court will not be beguiled by the form of the court's holding below. On the contrary, this Court should "examine the entire record, including the evidence . . . to determine whether what purports to be a finding upon questions of fact is so involved with and dependent upon such questions of law as to be in substance and effect a decision of the latter." *Kansas City So. Ry.* v. *Albers Comm. Co.*, 223 U.S. 573, 591. See also *Sterling* v. *Constantin*, 287 U.S. 378, 398; *Great Northern Ry.* v. *Washington*, 300 U.S. 154, 167; *United Gas Co.* v. *Texas*, 303 U.S. 123, 143; *Hooven & Allison Co.* v. *Evatt*, 324 U.S. 652, 659.

The decision below infringes the ruling of this Court in *Frost & Co.* v. *Mines Corp.*, 312 U.S. 38. There the State Court sustained a defense to an investor's contract action solely on the grounds that the Securities Act barred the suit by rendering the underlying contract void. This Court reversed the State court's adding to "the sanctions which Congress has defi-

[5] The court below was much impressed with the fact that the plaintiff Futrovsky had conceded that he for one had received a prospectus in 1959. (App. 10a). Futrovsky's admission, however, merely proved he was in no position to, and indeed had no interest in, pursuing the question before the Chancery Court as to whether all stockholders had received a prospectus. The failure of the court below to understand the implications of Futrovsky's admission also led it to depart from *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. 541, 549-50, for it accepted a settlement negotiated by one who could not faithfully assume a "position having a fiduciary character" as the "self-chosen representative and a volunteer champion" of all the Giant stockholders.

nitely provided" (at 42), where it would not further the Act's essential purpose of protecting innocent investors, but actually hinder that purpose. Similarly here, the lower court has "misinterpreted and improperly applied the Securities Act" (at 45) to the detriment of investors by giving the Act a broader reach than intended by Congress.

CONCLUSION

The question presented by the decision below is a narrow, but important, question of interpretation of the Securities Act, not involving the exact contours of the duty to deliver a prospectus, but only broadly whether there is the legal duty to deliver to all prospective buyers prior to their purchasing newly-issued shares. The novel interpretation of the federal statute below— in order to perpetuate the profiteering of corporate officers and directors described in the prospectus—is supported by no authority or facts of record. It is urged that a writ of certiorari to review the decision and decree of the court below be granted, and that this Supreme Court rule that the court below may not so misread and misuse the Securities Act.

Respectfully submitted,

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January, 1966.